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No. 82-1041

In the Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND ESTATE OF PAUL B. DICKMAN, DECEASED, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

REX E. LEE
Solicitor General
Department of Justice
Washington, D. C. 20530
(202) 633-2217

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MEMORANDUM FOR THE RESPONDENT

The question presented in this federal gift tax case is whether Paul and Esther Dickman's interest-free loans to their son and to a family-owned corporation constitute taxable gifts in the amount of the value of the loans measured by statutory rates of interest.

The pertinent facts are undisputed and may be summarized as follows: Paul and Esther Dickman were husband and wife until Paul's death in December 1976 (Pet. App. 2a, 17a). Over a period of years, they made interest-free loans totalling hundreds of thousands of dollars to their child, Lyle C. Dickman, and to a family-owned corporation, Artesian Farms, Inc. ("Artesian") (*id.* at 2a, 18a-19a).[1] The outstanding balances of the loans at the end of each

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[1]Lyle died on May 13, 1976 (Pet. App. 18a). Artesian's stock ownership is set out in the court of appeals' opinion (*id.* at 2a n.1).

calendar quarter of 1971 through 1976 are set forth in the court of appeals' opinion (Pet. App. 2a n.2). With two exceptions, all loans were evidenced by noninterest bearing demand notes. One exception was a loan made to Lyle on "open-account" and payable on demand. The other was a loan in the amount of $456,805.90 made to Artesian in March 1972, and evidenced by a ten-year term note (*id.* at 2a-3a, 19a-20a).

On audit, the Commissioner of Internal Revenue concluded that the loans resulted in taxable gifts to the extent of the value of the loans. Accordingly, he determined deficiencies in gift tax for all calendar quarters in the years 1971 through 1976, totalling $83,332.69 (Pet. App. 3a-4a, 21a).[2] In this proceeding brought by petitioners to contest the Commissioner's determination, the Tax Court followed its prior decision in *Crown* v. *Commissioner*, 67 T.C. 1060 (1977) (reviewed by the court), nonacq., 1978-2 Cum. Bull. 3, aff'd, 585 F.2d 234 (7th Cir. 1978), where it had held that intra-family, interest-free loans, payable on demand, did not result in taxable gifts. Accordingly, the court held that the instant loans did not result in taxable gifts (Pet. App. 15a-24a).[3]

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[2]The Commissioner determined the amount of the gifts by multiplying the loan balance outstanding at the end of each taxable quarter by interest rates ranging between 6% and 9%, which were the rates applicable under 26 U.S.C. (& Supp. V) 6601 and 6621 to tax underpayments (Pet. App. 3a n.4, 21a).

[3]In the notices of deficiency, the Commissioner treated all the loans as if they were payable on demand, each resulting in a continuing gift for the period during which the loan was left outstanding. By amended answer, however, the Commissioner contended that the $456,805.90 loan was a 10-year term loan and resulted in a gift in the calendar quarter in which the loan was made, equal to the difference between the amount lent and the fair market value of the term note given by Artesian (Pet. App. 21a). The Tax Court, however, rejected this argument, finding that the loan in question in fact was a demand loan (*id.* at 23a-24a). See further page 3 note 5, *infra*.

The court of appeals reversed (Pet. App. 1a-14a).[4] Disagreeing with the Seventh Circuit's *Crown* decision, the court held that "interest-free loans are subject to the gift tax whether the loans are made for a fixed term or are on a demand basis" (*id.* at 1a). The court found this conclusion "compelled by the gift tax statute as it is illuminated by its legislative history, established treasury regulations, judicial interpretation, and the policy considerations underlying it" (*id.* at 13a).[5]

DISCUSSION

1. The decision below correctly held that Paul and Esther Dickman made taxable gifts by making interest-free loans to their son and to a family-owned corporation.[6]

The gift tax is intended to reach every transfer for less than full and adequate consideration of any type of property, right to property, or interest in property having value. Section 2501(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. & Supp. V) (App., *infra*, 1a) imposes a gift tax on "the transfer of property by gift" by an individual. Section 2511(a) (App., *infra*, 1a) provides that "the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." See

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[4]The opinion of the court of appeals is reported at 690 F.2d 812 (1982).

[5]The court of appeals remanded the case to the Tax Court to determine the amount of the taxable gifts (Pet. App. 1a). The court declined to decide whether the Tax Court had correctly found that the $456,805.90 loan was a demand loan, stating that the characterization of that loan relates to the valuation issue, and "it is not absolutely clear at this point what difference the characterization will make since we hold that both term and demand loans produce taxable consequences" (*id.* at 3a n.3).

[6]The income tax consequences arising from nonarms'-length loan transactions are not at issue here (see Pet. App. 12a-13a n.8).

also Section 2512(b). The gift tax does not turn on a showing of donative intent. Rather, any transfer not in the ordinary course of business that is for less than full and adequate consideration is a taxable gift. *Commissioner* v. *Wemyss*, 324 U.S. 303, 306-307 (1945).

The committee reports accompanying the Revenue Act of 1932, ch. 209, Sections 501-507, 47 Stat. 245-249, which enacted the present federal gift tax, reflect Congress' specific intention to reach any gratuitous transfer of any interest in property:

> The terms "property," "transfer," "gift," and "indirectly" are used in the broadest and most comprehensive sense; the term "property" reaching every species of right or interest protected by law and having an exchangeable value.
>
> The words "transfer * * * by gift" and "whether * * * direct or indirect" are designed to cover and comprehend all transactions (subject to certain express conditions and limitations) whereby, and to the extent * * * that, property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment.

H.R. Rep. No. 708, 72d Cong., 1st Sess., 27-28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932).

The Treasury Regulations likewise embody the same broad definition of a taxable gift. They state:

> Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

Treasury Regulations on Gift Tax (26 C.F.R.), Section 25.2511-1(c).

This Court has reaffirmed on several occasions that the gift tax provisions should be broadly applied to effectuate the clear, sweeping intent of Congress. In *Commissioner* v. *Wemyss, supra*, 324 U.S. at 306, the Court stated that, "Congress intended to use the term 'gifts' in its broadest and most comprehensive sense," and acknowledged "the evident desire of Congress to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech." In *Smith* v. *Shaughnessy*, 318 U.S. 176, 180 (1943) (emphasis added), the Court stated that "[t]he language of the gift tax statute, 'property * * * real or personal, tangible or intangible,' is broad enough to include property, *however conceptual or contingent.*" See also *Robinette* v. *Helvering*, 318 U.S. 184, 187 (1943) (the purpose of the gift tax was to "reach every kind and type of transfer by gift").

Here, Paul and Esther Dickman gave their son, Lyle, and their family (through their corporation Artesian)[7] the right to use hundreds of thousands of dollars for extended periods of time. Clearly, these were transactions, in the language of Section 25.2511-1(c) of the Regulations, "whereby property or property rights or interests [were] gratuitously passed or conferred upon another" and consequently were subject to the gift tax. It is fundamental that the *right* to use property for a pre-determined definite period of time is itself "property," whether that underlying property is real estate, money[8] or other property. *Threlfall* v. *United States*, 302 F. Supp. 1114, 1118-1119 (W.D. Wis. 1969) (term leasehold is property); *Allen* v. *Commissioner*, 57

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[7]A gratuitous transfer to a corporation is treated as a gift to the shareholders in proportion to their ownership interests in the corporation. Treasury Regulations on Gift Tax (26 C.F.R.), Section 25.2511-1(h)(1).

[8]For these purposes, money is "property." See H.R. Rep. No. 708, *supra*, at 30.

T.C. 12 (1971) (same). This is also true where the right to use property is not for a definite predetermined period, but is to last for some indefinite period.[9] It is equally clear that the right to use property for an indefinite period, terminable at any time by the property's owner, also is "property."[10]

The transfers of the legal rights to use, interest-free, hundreds of thousands of dollars in this case were therefore transfers of "property," whether these rights were to last for a predetermined period or were terminable at any time by the lenders. Further, it is conceded that those transfers were made without consideration. Under the plain terms of the statute, those transfers constituted taxable gifts.[11] See *Blackburn* v. *Commissioner*, 20 T.C. 204 (1953) (transfer of property for term note bearing below-market interest was taxable gift); *Estate of Berkman* v. *Commissioner*, 38

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[9]See Treasury Regulations on Gift Tax, Section 25.2512-5(c) (right to use property for the life of another person is property); *Abbott* v. *United States*, 74-2 U.S.Tax Cas. (CCH) para. 13,040 (S.D. Miss. 1974) (same); *Sullivan* v. *Commissioner*, 16 T.C. 228, 231 (1951), acq., 1951-1 Cum. Bull. 3 (right to use property for duration of war is property); *Thriftimart, Inc.* v. *Commissioner*, 59 T.C. 598, 615-616 (1973), acq., 1973-2 Cum. Bull. 4, remanded on other issues (9th Cir. Dec. 10, 1975) (lease which is terminable by owner on sale of building is property).

[10]See, e.g., *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1963) (the right to use real estate for such time as the owner permitted was property); Rev. Rul. 73-61, 1973-1 Cum. Bull. 408. See also *Threlfall* v. *United States, supra*; *Allen* v. *Commissioner, supra*, 57 T.C. at 14.

[11]Contrary to petitioners' statement (Pet. 3), the court of appeals here did not "impute" interest, any more than taxing a gift of stock "imputes" sales proceeds. The court simply held that since Paul and Esther Dickman transferred "property," i.e., the right to use money, for less than full and adequate consideration, they made taxable gifts. The only relevance of interest would be in determining the amounts of the gifts. The arms-length interest rate a borrower would have to pay to obtain a similar loan should measure the value of the gift, just as an arms'-length sales price would measure the value of, for example, a gift of stock.

T.C.M. (CCH) 183 (1979) (term loan bearing below-market interest was taxable gift); Rev. Rul. 73-61, 1973-1 Cum. Bull. 408. Cf. *Mason* v. *United States*, 513 F.2d 25 (7th Cir. 1975). See also Treasury Regulations on Gift Tax, Section 25.2511-2(f), which provides that, in the case of a transfer of property which is an incomplete gift because the donor retains dominion and control, any "enjoyment of the transferred property by the transferee" during the period before the gift is complete "constitutes a gift of such * * * [beneficial] enjoyment taxable as of the calendar quarter * * * of its receipt."[12]

Moreover, the decision below furthers two basic purposes of the gift tax. That tax, in addition to being an independent tax in its own right, was designed to supplement and protect both the estate tax and the income tax by taxing inter-vivos gifts and thereby preventing taxpayers from reducing their yearly incomes as well as their gross estates through tax-free gifts to close family members and others. *Smith* v. *Shaughnessy, supra*, 318 U.S. at 179 n.1; *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 45 (1939).

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[12]The conclusion that interest-free loans, whether term or demand, result in taxable gifts has received strong support from the commentators, who have sharply criticized the holdings of both the Tax Court and the court of appeals in *Crown*. See, e.g., S. Surrey, W. Warren, P. McDaniel & H. Gutman, *Federal Wealth Transfer Taxation: Cases and Materials* 154-156 (2d ed. 1982); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* para. 10.01[2][f], at 10-10 & S10-1 to S10-2 (4th ed. 1978 & Cum. Supp. No. 2, 1982); H. Dubroff & D. Kahn, *Federal Taxation of Estates, Gifts, and Trusts* para. 20.02, at 314 (3d ed. 1980); Joyce & Del Cotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 Tax L. Rev. 459, 468-469, 489-490 (1980); Pulliam, *Income and Gift Tax Implications of Nonbusiness Interest-Free Loans: Looking a Gift Horse in the Mouth*, 58 Taxes 675 (1980); Carey, *Interest-Free Loans and the Gift Tax: Crown* v. *Commissioner*, 38 Ohio St. L.J. 903, 907-916 (1977). See also O'Hare, *The Taxation of Interest-Free Loans*, 27 Vand. L. Rev. 1085, 1088 (1974).

See H.R. Rep. No. 708, *supra*, at 28; S. Rep. No. 665, *supra*, at 40. Here, Paul and Esther Dickman succeeded in shifting to Lyle and Artesian the income that would be generated by the money lent them, thereby reducing their income taxes, and ultimately the amounts of their taxable estates. Indeed, as the Seventh Circuit in *Crown* acknowledged with respect to this income-splitting device (585 F.2d at 236) (emphasis added; footnote omitted):

> The concern here is that people will use gifts of income producing property to split up an income taxable in a high tax bracket into smaller incomes taxable in lower brackets. *No-interest loans do just that.* Moreover, where the loans are payable on demand, the maker of the loans is able to achieve this result without the inconvenience of losing access to the principal should the need arise.

2. We do, however, agree with petitioners (Pet. 3) that the decision below squarely conflicts with that of the Seventh Circuit in *Crown* v. *Commissioner, supra.*[13] There, a family-owned partnership made interest-free demand loans totalling more than $18 million to a series of trusts established for the children and other close relatives of the partners. The Seventh Circuit, with one judge dissenting, held that the loans had no gift tax consequences.[14] The court in *Crown* acknowledged the "broad sweep of the gift tax statutes," but concluded that demand loans did not come within the statutory definition of a taxable gift (585

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[13]The decision also conflicts with that of the district court in *Johnson* v. *United States*, 254 F. Supp. 73 (N.D. Tex. 1966).

[14]The Seventh Circuit intimated, however, that an interest-free *term* loan might result in a taxable gift (see 585 F.2d at 237 & n.7). But as the court here correctly held, interest-free loans result in gifts whether made on a term or demand basis (Pet. App. 1a). The only difference will be in the method of valuation and timing of the gift. See page 3 note 5, *supra*.

F.2d at 238-240). The court's fundamental error, we submit, was its failure to recognize two principles: First, that the right to use property is itself "property" within the meaning of the statute. Second, as the court below analyzed the transaction (see Pet. App. 11a), an interest-free demand loan is an ongoing gift of property for as long as the lender permits the borrower to retain the money, and that consequently the amount of the gift depends on the period the loan is left outstanding.

Tax practitioners and financial advisers have widely recognized and advocated the use of interest-free loans as a tax-free device to split incomes and reduce estate taxes.[15] Indeed, in *Crown* the taxpayers successfully transferred, tax free, property worth more than $1 million to their children and other close relatives. See 67 T.C. at 1065.

The issue is one of substantial and continuing importance in the administration of the tax laws. We are advised by the Internal Revenue Service that there may be as many as 31 pending cases, either in litigation or at the administrative level, in which this issue is raised, and that these cases may

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[15]See, e.g., Bettner, *Interest-Free Loan to Poorer Relation Can Cut Income Taxes if He Invests Money in His Name*, Wall St. J., Dec. 20, 1982, at 42, col. 1; Thater & Richey, *An Overview of Cases Dealing with Interest-Free Loans*, 121 Trusts & Estates, No. 12, at 35 (Dec. 1982); Mitchell, *Interest-Free Loans: Opportunities for Tax Planning*, 65 A.B.A.J. 634, 636 (1979); Edwards, *What Planning Opportunities Does CA-7's No-Gift Tax Holding in Crown Open Up?*, 50 J. Tax. 168, 170 (1979); Aslanides & McGowan, III, *Interest-Free Loans Get Green Light as Compensation and Estate Planning Devices*, 21 Tax. Acct. 260, 264-265 (1978); Taicher, *How to Use Interest-Free Loans in Family Tax Planning*, 11 Prac. Acct. 24, 27-28 (Sept. 1978); Tidwell, *Lester Crown Points the Way to Estate Tax Reduction Under the 1976 Tax Reform Act*, 55 Taxes 651 (1977); Burke, Jr., *Interest-Free Loans — A Valuable Family Tax Planning Tool?*, 48 Taxes 137 (1970); Seidman & Stuetzer, Jr., *Tax Clinic*, 120 J. Acct. 75 (Dec. 1965).

involve as much as $5.5 million in tax.[16] Accordingly, we do not oppose the granting of the petition for a writ of certiorari.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

REX E. LEE
Solicitor General

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[16]The actual revenue impact of the interest-free loan gift tax issue may well be far greater than even these figures indicate. Intra-family loans are necessarily difficult to uncover on audit. In addition, although interest-free loans worth in excess of the $10,000 per donee annual exclusion (26 U.S.C. (& Supp. V) 2503(b)) would deplete the taxpayer's available unified credit against gift tax (26 U.S.C. (& Supp. V) 2505), currently equivalent to an "exemption" from the gift tax for $275,000 in gifts, there would be no gift or estate tax consequences until that credit was exhausted. See further Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 Colum. L. Rev. 161, 186 (1977).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

Section 2501. Imposition of tax

[as amended by Section 109(a), Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539, and Section 102(a)(1), Excise, Estate, and Gift Tax Adjustment Act of 1970, Pub. L. No. 91-614, 84 Stat. 1838.]

(a) *Taxable Transfers*

"(1) *General rule.*—For the first calendar quarter of calendar year 1971 and each calendar quarter thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident."

* * * * *

Section 2511. Transfers in general

(a) Scope

Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *.